

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of )  
W. L. AND ANN APPLEFORD )

Appearances:

For Appellants: W. L. Appleford, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel

O P I N I O N

These appeals are made pursuant to Section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board denying the respective claims of W. L. and Ann Appleford for refund of personal income tax in the amounts of \$2,620.66 and \$2,616.99 for the year 1951 and pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on their protests against proposed assessments of additional personal income tax in the amounts of \$979.27 and \$998.50, respectively, for the year 1953.

Prior to 1947 W. L. Appleford obtained from the State of California an oil and gas lease on certain tide and submerged lands lying off the California coast. Under the lease, a 5 percent royalty was to be paid to California. Appleford then entered into an operating agreement with the Signal Oil and Gas Company for the development of the lease. The agreement, which was to terminate on July 28, 1950, provided for payment of a 2.2 percent royalty to Appleford and the 5 percent royalty to the State of California.

This arrangement continued until June 23, 1947, when the United States Supreme Court decided:

... that California is not the owner of the three-mile marginal belt along its coast, and that the Federal Government rather than the state has paramount rights in and power over that belt, an incident to which is full dominion over the resources of the soil under that water area, including oil. (United States v. California, 332 U. S. 19, 38 [91 L. Ed. 1889, 1899-J.] )

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Because this decision made uncertain the rights of parties holding leases from California, Signal thereafter impounded Appleford's royalties.

The United States Government entered into stipulations with the State of California giving the holders of operating rights under state leases permission to continue producing and drilling operations, subject to liability to the United States for the value of the oil produced after deducting all reasonable costs of production, including royalties paid to California. California's royalties were to be segregated and held by the state in a special fund.

The stipulation did not make clear whether an operator could pay overriding royalties to persons in Appleford's position without becoming liable to the United States. Consequently, Signal sent monthly statements to Appelford, without payment, throughout the years 1947, 1948, 1949 and 1950. The stipulation was amended in September, 1951, to provide that overriding royalties could be deducted as part of the reasonable costs of production. Accordingly, on October 10, 1951, Signal paid Appleford \$127,342.06 as royalties for the period June 23, 1947, to July 28, 1950, which was the termination date of the original lease.

Prior to its expiration, Signal attempted to renew the lease between Appleford and the state. California agreed to a renewal provided its royalty was increased to 16-2/3 percent. The stipulation between the United States and California **however**, provided that any renewal was subject to disapproval by the Secretary of the Interior. The Secretary refused to give his approval and Signal again impounded all of the royalties which would have been payable to Appleford under the renewal.

On kay 22, 1953, Congress enacted the Submerged Lands Act (67 Stat. 29-32,43 U.S.C.A. §§ 1301-1303, 1311-1315) which vested control of the three-mile marginal belt in the various coastal states. On June 11, 1953, Signal paid Appleford \$63,859.19 in royalties for the period July 28, 1950, to April 30, 1953. He received an additional \$11,123.62 as royalties for the balance of 1953, making a total or \$74,982.86 received in that year.

The Appellants, husband and wife, each filed separate returns for the years 1947 through 1953, including in reported income one-half of the royalties shown for each year by Signal's monthly statements. The Franchise Tax Board determined that all of the royalties received by Appellants in 1951 should be taxed in that year and not taxed as reported by Appellants in 1947, 1948, 1949 and 1950. Accordingly, Respondent issued proposed assessments for 1951, giving appropriate credit for the amounts by which Appellants overpaid their taxes in the earlier years. Appellants appealed to

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this Board and we upheld the Franchise Tax Board's action, (Appeals of W. L. and Ann Appleford, Cal. St. Bd. of Equal., Sept. 15, 1958, 2 CCH Cal. Tax Cas. Par. 200-932, 3 P-H State & Local Tax Serv. Cal. Par. 58129.) On May 8, 1959, Appellants paid the assessed tax and filed claims for refund with Respondent on the ground that they had reported the royalties in the proper years.

Respondent later discovered an error in its computations, indicating that Appellants overpaid their 1951 taxes by approximately \$1,045.76 each due to the fact that the Franchise Tax Board had included in its 1951 assessments royalties earned in 1950 and 1951 which were not actually received until 1953 and thus, under Respondent's theory, were not taxable to Appellants until 1953.

Respondent advised Appellants to file new claims for refund for these amounts on or before May 11, 1960, the last date on which such claims could be timely filed. On January 16, 1960, Appellants replied, insofar as is relevant here, that

... we may assume that our protested payment consisted of an amount in excess of the amount your office now contends is due.

Since we have already made claim for the refund of the entire amount of additional tax and interest for the year 1951, we, of course, still stand on our claim ....

May we for our files now have a detailed summary of your corrected computations.

Meanwhile, on July 20, 1959, the Franchise Tax Board mailed assessments to Appellants proposing to include in their 1953 income all of the royalties received by them in that year. Pursuant to Section 19053.9 of the Revenue and Taxation Code, which allows an offset for overpayments of tax up to seven years from the due date of the return on which the overpayment occurred, Appellants were given an offset for the 1952 tax on royalties they had reported. No offset was given for 1951 since more than seven years had elapsed. The overpayment on royalties reported for 1950 had already been credited in the 1951 assessment so no additional adjustment for that year was necessary.

This appeal relates to both the refund claims for 1951 and the proposed assessments for 1953;

On the ground that Appellants were on the cash basis of reporting income, we have previously decided that the royalties received in 1951 were taxable in that year and not during the

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years when Signal retained them. (Appeals of W. L. and Ann Appleford, supra, Cal. St. Bd. of Equal. Sept. 15, 1958 2 CCH Cal. Tax Cas. Par. 200-932, 3 P-H State's Local Tax Serv. 341, Par. 58129,) Appellants now contend that their returns were filed on the accrual basis for the years 1950 to 1953, inclusive. This contention affects a portion of the royalties received in 1951 under the old lease and all of the royalties received in 1953 under the new lease.

Appellants filed their returns on the cash basis before 1947, when the royalties were first impounded, and have never sought or obtained permission to change to the accrual basis as required by Respondent's regulations. (Cal. Admin. Code, Tit. 18, Reg. 17556-17557(b), published in 1946, formerly Pers. Income Tax Regs. Art. 16(a)-2 and now Cal. Admin. Code, Tit. 18, Reg. 17561, Par. (e).) Thus, all of the royalties must be accounted for on the cash basis (American Conservation Service Corp., 24 B.T.A. 183; Shoong Investment Co. v. Anglim, 45 F. Supp. 711) and, in accordance with our prior decision, they are taxable as of 1951 and 1953, when they were received. In view of our conclusion on this point, it is unnecessary to decide a contention by Respondent that Appellants in fact filed their returns on the cash basis until 1953 or a further contention that even on the accrual basis the impounded royalties would be taxable only when Signal released them.

Respondent states that it has erroneously assessed Appellants for 1951 and that the amounts of overpayment, \$1,045.76 each, would be subject to refund if proper claims were timely filed. It argues, however, that Appellants can recover only on the grounds stated in their refund claims. Since Appellants chose to stand on their original claims, Respondent urges that no refund may be granted.

A timely refund claim for the entire assessment was filed; any defect, therefore, lies in the sufficiency of the grounds for relief stated in the claim. Here the Franchise Tax Board discovered its own error and advised Appellants of it. Although Appellants did not file a new claim specifically on this ground, we interpret their letter of January 16, 1960, as accepting the acknowledged error as an alternative basis for refund. We think that Appellants' claims were thus timely amended and were sufficient to entitle them to refund of the amounts that were erroneously collected,

Allowance of these amounts obviates the need for discussion of an additional issue of whether Appellants are entitled to an offset against the 1953 assessment for the 1951 overpayment.

The proposed assessments for 1953 were issued more than four but less than six years after the date the returns were

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filed, pursuant to Section 18586.1 of the Revenue and Taxation Code, which states:

If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, a notice of a proposed deficiency assessment may be mailed to the taxpayer within six years after the return was filed.

It is undisputed that the amount of income which we have found was properly includible in Appellants' gross income for 1953 and which was not so reported, greatly exceeds the 25 percent requirement laid down in the above section. A close examination of the 1953 returns filed by Appellants reveals no clue which would have advised the Franchise Tax Board of the omitted amounts which had already been reported in earlier returns.

Appellants argue that due to the fact that the omitted income had been included in returns for earlier years which were "accepted" by the Franchise Tax Board, Section 18586.1 is not applicable. We cannot agree. The language of Section 18586.1 closely parallels that of former Section 275, Subd. (c) of the Internal Revenue Code of 1939. The Federal cases applying this language make clear that the disclosure of income is effective only if made on the return in question or its accompanying schedules. (Corr Commissioner, 155 F. 2d 164; Ewald v. Commissioner, 141 F. 2d 750; Mel Dar Corp., T. C. Memo., Dkt. Nos. 60997, 68821 and 71208, March 3, 1960, rev'd on other grounds, 309 F. 2d 525.) We conclude that Respondent properly applied Section 18586.1.

Appellants also contend that the State of California is estopped from collecting the 1953 assessment on the ground that it was responsible for the situation which gave rise to the delay in royalty payments. We rejected essentially this same argument in Appellants' earlier appeal. Signal's refusal to pay over royalties for the later period was predicated on the Secretary of the Interior's refusal to approve the lease extension, something for which the State of California can hardly be held responsible. Under these facts, we perceive no bar to the imposition of the tax as proposed by the Franchise Tax Board.

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O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board denying the respective claims of W. L. and Ann Appleford for refund of personal income tax in the amounts of \$2,620.66 and \$2,616.99 for the year 1951 be modified in accordance with the opinion of this Board and pursuant to Section 18595 of the Revenue and Taxation Code that the action of the Franchise Tax Board on their protests against proposed assessments of additional personal income tax in the amounts of \$979.27 and \$998.50, respectively, for the year 1953, be and the same is hereby sustained.

Done at Pasadena, California, this 25th day of June, 1963,  
by the State Board of Equalization.

John W. Lynch, Chairman

Paul R. Leake, Member

Geo. R. Reilly, Member

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ATTEST: R. G. Hamlin, Acting Secretary